



**STATE INVESTMENT BOARD
BOARD ADOPTED POLICIES**

POLICY NUMBER: 2.10.050

EFFECTIVE DATE: 6/20/02

TITLE: Retirement CTF Asset Allocation

SUPERSEDES: 1/17/02

BOARD ADOPTION: 6/20/02

APPROVED:

A handwritten signature in black ink, appearing to read 'B. B. B.', is written over the 'APPROVED:' label.

PURPOSE:

This document outlines the asset allocation policy and performance objectives for the Washington State Investment Board (SIB) Retirement Commingled Trust Fund (CTF) and supersedes any prior Board-adopted policies.

The selection of asset classes, the amount invested in each, and the correlation of those asset classes are the greatest source of return and risk to the CTF. Therefore, the apportionment and management of the asset allocation is the foundation of the investment program and crucial to its success. The asset allocation policy, when viewed along with the respective investment policies in each asset class, constitutes the Board's view of a prudent and well-reasoned approach to the management of the entrusted funds.

BACKGROUND:

With the introduction of defined contribution features in the state's retirement plans, and in accordance with statutory mandate, the SIB currently invests both defined contribution and defined benefit assets in the CTF. The major portion of the fund is defined benefit assets which are considered to be long-term in nature. The defined contribution program allows participants access to the defined contribution portion of the CTF assets on a monthly basis and can be transferred in entirety, at their discretion.

POLICY:

Asset Allocation Objectives & Constraints

The SIB's mandate, as stated in the Revised Code of Washington (RCW 43.33A.110 and RCW 43.33A.140), is to maximize return at a prudent level of risk. The allocation decision defines the expected return and level of risk of the portfolio. The decision process is a multi-level process incorporating the following:

1. The inclusion of multiple asset classes with varying risks and correlations (capital market assumptions);
2. The optimal portfolio lying on the efficient frontier (includes any constraints to the asset classes); and,
3. The Board's comfort level with risk and the rewards (return) associated with the risk.

The asset allocation for the CTF is formally reviewed every three to four years. The allocation policy will be reviewed more frequently if the Board believes there has been a fundamental change in the structure of the capital markets or in the underlying cash flow/structure of the retirement systems. The asset mix is reviewed monthly by both the staff and Board. The Board delegates to the executive director the authority to rebalance the asset mix as required. The staff procedure for rebalancing is delineated in SIB Policy 3.10.100, Volume 3.

Asset Allocation

1. The asset allocation target is established by the Board and must be considered at all times when making investment decisions.
2. The range around the allocation targets is intended to keep the actual allocation close to the target while minimizing the transactions costs which result from rebalancing. The asset mix may deviate from the target as shown below. Deviations outside the range may require rebalancing back to the target.

<u>Asset Class</u>	<u>Target</u>	<u>Policy Range</u>	<u>Asset Class Range</u>
U.S. Equity	31%	26 - 36%	+ or - 5%
Non-U.S. Equity	15%	12 - 18%	+ or - 3%
Fixed Income	25%	21 - 29%	+ or - 4%
Real Estate	12%	10 - 14%	+ or - 2%*
Private Equity	17%	13 - 21%	+ or - 4%**
Cash	0%	0 - 2%	+ 2%

- * If Real Estate, due to timing or illiquidity, is off its target, then Fixed Income will be used to offset the imbalance.
- ** If Private Equity, due to timing and/or illiquidity, is off its target, then U.S. Equity will be used to offset the imbalance.

While it is the Board's goal to reach the long-term target (optimal portfolio) as quickly as possible, because of the illiquidity and time lagging nature of Real Estate and Private Equity asset classes, it is assumed that it will take time to achieve the target. The chart below reflects the projected allocations for the coming years:

	<u>Year-end Target</u>			
<u>Asset Class</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
U.S. Equity	32%	31%	31%	31%
Non-U.S. Equity	15%	15%	15%	15%
Fixed Income	28%	27%	26%	25%
Real Estate	9%	10%	11%	12%
Private Equity	16%	17%	17%	17%

3. Recommendations for the allocation to specific investments within the target allocation is an investment structure decision and will be the responsibility of the appropriate SIB Committee. However, the Committee is expected to maintain the return and risk posture of the asset class.

Rebalancing Procedure

1. The Board delegates to the executive director the authority to rebalance the CTF asset allocation within the procedures established in SIB Policy 3.10.100, Volume 3.
2. In cases of major rebalancings, the Board authorizes the executive director to utilize futures, forward contracts and options, in order to maintain exposure in asset classes and to reduce transaction costs that would otherwise be incurred by the buying and selling of actual securities. Major rebalancing can occur to bring asset classes within their target ranges, or when the Board is transitioning managers.
3. Idle cash will be allocated to asset classes and investment managers based on target allocations. The cash balance may deviate outside its target ranges in anticipation of large cash transfers (e.g., Plan 3 transfers).
4. Assets will be rebalanced across asset classes, as appropriate, when market values of assets fall outside policy ranges. Rebalancing will be accomplished first using normal cash flows and second through reallocation of assets across asset classes. The timing of the re-

balancing will be based on market opportunities and the consideration of transaction costs, and therefore need not occur immediately.

5. The rebalancing of public securities will be accomplished first using normal cash flows and second through reallocation of assets within asset classes. This reallocation will be based on individual asset class policies or upon recommendations by the appropriate Committee.

Because of appraisal valuation and illiquid market nature of appraised assets, exceeding the maximum policy range allocation will trigger a conscious review by the Administrative Committee and the appropriate asset class committee rather than automatic rebalancing.

6. The above policy ranges are long-term and may deviate in the short-term as a result of funding schedules, interim market movements and market impact costs of implementation.

Performance Benchmark Objective

The CTF's performance benchmark objective is to exceed the return of a policy benchmark consisting of public market indices weighted according to asset allocation targets. The performance benchmark will adjust in-line with the Board-adopted asset allocation implementation plan. Based on the current allocation, the long-term performance objective consists of the following benchmark:

Long Term – 60% Wilshire 5000, and 15% MSCI ACWI Free index ex U.S.,
25% Lehman Universal.

The custom benchmark may vary over the short run to more closely match the true allocations to Private Equity and Real Estate.

Review of Asset Allocation Policy

Market and fund conditions are dynamic, not static. Therefore, the asset allocation policy statement and general CTF investment policy should be reviewed by the Committee at least annually and any suggested changes recommended to the Board. A formal asset allocation review should be completed every three to four years and more frequently if fund objectives change.

Reporting

SIB staff will report the actual asset allocation to the Board monthly.

Responsibilities

1. Board - Responsible for approving CTF asset allocation and investment policy and for monitoring that allocations are maintained within target ranges.

2. Administrative Committee - Responsible for reviewing and recommending the CTF asset allocation and investment policy to the Board.
3. Public/Private Markets Committees - Responsible for structural investments within the asset allocation policy (and appropriate asset class policies) and assisting with allocation management as indicated above.
4. Staff - Responsible for reviewing the asset allocation monthly, monitoring future anticipated cash flow and rebalancing to the targets (shifts across asset classes will be reported as soon as practical to the Board as part of the monthly asset allocation review). Responsible for implementing and maintaining the policy and reporting to the Administrative Committee and the Board.

Policy Adopted 6/29/81

Revised 9/15/92

Revised 10/20/92

Revised 5/20/93

Supersedes Policies 2.10.200 dated 6/19/89; 2.10.300 dated 8/8/83; and, 2.10.500 dated 8/13/84

Revised 11/17/94

Revised 8/21/97

Revised 3/18/99

Revised 4/15/99

Revised 4/20/01 (Supersedes Policy 2.05.100, 4/15/99)

Revised 1/17/02

Revised 6/20/02